



Village of Chatham

Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

June 1, 2011 — September 26, 2012

2013M-132



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
Background	5
Objective	5
Scope and Methodology	6
Comments of Local Officials and Corrective Action	6
PAYROLL	7
Accrual Records	7
Time and Attendance Records	8
Recommendations	9
JUSTICE COURT OPERATIONS	10
Monthly Bank Reconciliation and Accountability Analysis	10
Cash Receipts	11
Annual Audit	12
Recommendations	12
ACCOUNTING RECORDS AND CASH MANAGEMENT	13
Financial Records and Reports	13
Online Banking	15
Recommendations	18
APPENDIX A Response From Local Officials	19
APPENDIX B Audit Methodology and Standards	21
APPENDIX C How to Obtain Additional Copies of the Report	23
APPENDIX D Local Regional Office Listing	24

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2013

Dear Village Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Village Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the Village of Chatham, entitled Internal Controls Over Selected Financial Activities. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Village of Chatham (Village) is located in Columbia County. The Village is governed by an elected Board of Trustees (Board) comprising a Mayor and four Trustees. The Board is the legislative body responsible for managing Village operations. The Mayor is the chief executive officer; the Village Treasurer (Treasurer) is the chief fiscal officer (CFO). Throughout the audit period, the Village had two elected Justices, Mark Portin and David Harrison, Sr., who shared a court clerk and a clerk's assistant.

The Village offers a variety of services to its residents, including police protection, street maintenance and improvements, snow removal, water distribution, sewage treatment, and general government support. The Village's general fund budget for the 2012-13 fiscal year was approximately \$1.2 million.

Scope and Objective

The objective of our audit was to review internal controls over time and attendance and leave accrual records, Justice Court operations, and the CFO's financial activities, including the Village's online banking, for the period June 1, 2011, to September 26, 2012. Our review of Justice Court operations was extended to October 9, 2012. Our audit addressed the following related questions:

- Are internal controls over employee time and attendance and leave accruals appropriately designed and operating effectively?
- Are internal controls over Justice Court operations adequately designed and operating effectively for the proper accounting and reporting of financial activities?
- Did the system of internal controls adequately ensure that the Village's financial activity was accurately recorded and reported in a timely manner?

Audit Results

Village officials need to improve internal controls over the Village's time and attendance procedures and leave accruals. We identified 79 errors in nine employees' accrual records. There were no timesheets or other records of the days or hours worked, such as calendars and logs, for four salaried employees, and timesheets for two part-time employees were not signed by their supervisors. In addition, time and attendance records are not submitted by all employees and are not completed with consistency to capture start/end times and hours worked. Because of these deficiencies, Village officials do not have assurance that employees are being paid for time actually worked and are earning accruals they are entitled to.

Internal controls over the Court's operations were not appropriately designed or operating effectively to allow for proper accounting and reporting of financial activities. Bank reconciliations were not documented for Justice Harrison's account, and monthly bank reconciliations of Justice Portin's account showed a recurring, unresolved surplus balance of \$446 during the audit period. The Justices did not perform a monthly accountability analysis and did not ensure that sequentially numbered duplicate receipts were issued for all payments collected by the Court. Further, the Board did not perform or arrange for an annual audit of the Justices' books and records. As such, the Board was not in a position to detect and correct any irregularities that had occurred.

Internal controls over the Treasurer's activities and the Board's oversight of the Treasurer's financial operations also need to be improved. The Treasurer did not properly reconcile all Village bank accounts or update the accounting records in a timely manner. The Board did not ensure the reconciliations prepared by its accounting firm were timely, available to Village officials, or retained on file with Village records. Further, the Board did not ensure that adequate policies, procedures, and agreements were established for online banking and did not provide sufficient oversight of electronic funds transactions. Because of this lack of oversight, the risk is increased that errors or irregularities could occur without being detected and corrected.

Comments of Local Officials

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our findings and recommendations and indicated they plan to initiate corrective action.

Introduction

Background

The Village of Chatham (Village) is located in the Towns of Ghent and Chatham, in Columbia County, covers 1.2 square miles, and has a population of 1,770 residents. The Village is governed by an elected Board of Trustees (Board) comprising a Mayor and four Trustees. The Board is the legislative body responsible for managing Village operations. The Mayor is the chief executive officer. The Village Treasurer (Treasurer) is the chief fiscal officer (CFO), and is responsible for maintaining a record of all receipts, expenditures, and account balances, and for providing the Board with timely and accurate financial information. The Village offers a variety of services to its residents, including police protection, street maintenance and improvements, snow removal, water distribution, sewage treatment, and general government support. The Village's general fund budget for the 2012-13 fiscal year was approximately \$1.2 million.

During our audit period, the Village was served by an appointed Clerk-Treasurer, who retired at the end of 2011, and an appointed Treasurer,¹ who resigned shortly before we began audit fieldwork. Throughout the audit period, the Village had two Justices, Mark Portin and David Harrison, Sr., who shared a court clerk and a clerk's assistant. The Justices have jurisdiction over matters brought before the Justice Court (Court), and are required to report the Court's financial activities monthly to the Office of the State Comptroller's (OSC) Justice Court Fund (JCF). For the audit period, the Justices collected approximately \$108,000 in fines, fees and surcharges.

Objective

The objective of our audit was to review selected financial activities of the Village. Our audit addressed the following related questions:

- Are internal controls over employee time, attendance and leave accruals appropriately designed and operating effectively?
- Are internal controls over Justice Court operations adequately designed and operating effectively for the proper accounting and reporting of financial activities?
- Did the system of internal controls adequately ensure that the Village's financial activity was accurately recorded and reported in a timely manner?

¹ The Clerk-Treasurer was a full-time employee; the Treasurer was a part-time employee.

**Scope and
Methodology**

We examined the Village's internal controls over time and attendance, leave accrual records, Justice Court operations, and the CFO's financial activities, including online banking, for the period June 1, 2011, to September 26, 2012. We extended the audit period for our review of the Justice Court to October 9, 2012.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report.

**Comments of
Local Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our findings and recommendations and indicated they plan to initiate corrective action

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Village Clerk's office.

Payroll

Village officials are responsible for establishing an internal control system over payroll to ensure that employees are paid wages and salaries, and provided benefits, to which they are duly entitled. Good internal controls include policies and procedures to provide reasonable assurance that assets are properly safeguarded; that payroll transactions are authorized, recorded, and reported properly; and that work performed is monitored and reviewed. Management oversight and segregation of duties are also essential components of a good internal control system.

Village officials need to improve internal controls over the Village's time and attendance procedures and leave accruals. We identified 79 errors in nine employees' accrual records. There were no timesheets or other records of the days or hours worked, such as calendars and logs, for four salaried employees, and timesheets for two part-time employees were not signed by their supervisors. In addition, time and attendance records are not submitted by all employees and are not completed with consistency to capture start/end times and hours worked. Because of these deficiencies, Village officials do not have assurance that employees are being paid for time actually worked and are earning accruals they are entitled to.

Accrual Records

Leave accruals represent time off (vacation, sick, etc.) earned by employees. It is important for procedures to be designed to ensure that leave accruals are earned in accordance with Village policies, collective bargaining contracts, employment agreements, and/or Board resolutions, and that leave used is properly deducted from employee leave accrual balances. Proper accounting for employee leave accruals requires the periodic verification of records for leave accruals earned and used, to ensure that leave balances are accurate and up to date. In addition, someone other than an employee should maintain that employee's leave and accrual records. Changes and resultant balances entered on leave and accrual records should be routinely communicated to each employee to ensure accuracy.

The Clerk-Treasurer and Treasurer compiled and maintained attendance cards that included monthly leave balances for full-time employees earning and using leave accruals. All employees who earned leave accruals, except the Clerk-Treasurer, submitted timesheets.² The Clerk-Treasurer and Treasurer used the timesheets

² Payroll summaries compiled by the Police Chief or his designee were summarized from timesheets and submitted weekly to the Clerk-Treasurer.

and Police Department payroll summaries as source documents to update the attendance cards.³ The attendance cards maintained and retained by the Clerk-Treasurer and Treasurer comprised the leave accrual balance records.

We reviewed the weekly timesheets and payroll summaries submitted for the period June 1, 2011, through September 26, 2012, for all 10 full-time employees and compared them to the Village's records of time earned, leave taken, and resultant leave accrual balances. We found 79 errors in accrued leave balances (41 sick leave, 30 vacation leave, and eight personal leave). The errors included leave taken without leave accruals charged, charges to leave accruals exceeding leave time taken, errors in credited days earned, and calculation errors resulting in incorrect leave balances carried forward.

The Village does not use time off request forms. Rather, employees verbally make requests to their supervisor to take time off; the supervisor then is responsible to ensure that leave time taken is properly entered on employees' timesheets. For example, the Clerk said she informed the Mayor when she wanted to take leave time by phone or e-mail. However, the Mayor did not keep a written record of the Clerk's leave requests or retain copies of the e-mail requests. According to the Clerk, historically, quarterly reports were generated by the Treasurer and provided to full-time employees to advise them of their accrued leave balances; however, we found no formalized procedure for employees to confirm the accuracy of their balances.

Village officials' failure to ensure that accurate and complete leave accrual records are maintained diminishes the reliability of the records and resulted in incorrect unused leave balances being carried over to the next year or converted to cash payments.

Time and Attendance Records

A good system of internal controls over employee time and attendance consists of written policies and procedures that provide clear guidance for recording time worked. Policies and procedures should ensure that employees' time and attendance records are accurate and complete, and that employees' time records support leave accrual records. All employees should complete and sign (certify) a timesheet or use a machine-punched time card documenting time worked, including the starting and ending times of their shift/work day. Timesheets should be verified and signed by employees' immediate supervisors before being submitted for processing. These time and attendance records serve as the basis for employees to receive payment for time worked

³ Leave taken was recorded on an annual attendance card, with designations of I (sick leave), V (vacation leave) or P (personal leave). Monthly balances for each type of leave were recorded as of the beginning of each month.

and authorized paid leave taken. It is important that Village officials ensure and monitor employees' compliance with time and attendance policies and procedures.

We reviewed payroll records, including timesheets and payroll summaries, from June and July 2011 for all 10 full-time employees and selected a judgmental sample of 10 part-time employees to determine if timesheets were submitted and, if so, were signed by the employees and their supervisors. There were no timesheets or other records of the days or hours worked, such as calendars and logs, for four salaried employees,⁴ and timesheets for two part-time employees were not signed by their supervisors.⁵ In addition, there is no consistency in the format or content of timesheets used by Village employees; rather, only the total number of hours worked daily, not the start/end times, were included on the timesheets for seven⁶ of 16 employees' timesheets tested.

Properly documented and approved time records provide assurance that the recorded time worked by Village employees is accurate. They also provide a basis for accurate preparation of related payrolls, retirement reporting and leave accrual records.

Recommendations

1. Village officials should develop and implement written procedures to address the maintenance of leave time records and ensure that accurate information for time accruals is being maintained and monitored. Village officials also should institute procedures for random verification of the accuracy of the accrual records. These records should be maintained by using certified timesheets supported by time off requests as the primary source of information for leave time.
2. Village officials should ensure that all Village employees complete, submit, and certify timesheets to support hours worked.

⁴ Clerk-Treasurer, Justice, a Board member and the Assessor

⁵ Planning Board clerk and court clerk

⁶ Assistant Clerk, DPW employees, court clerk assistant and janitor

Justice Court Operations

Village Justices are responsible for adjudicating all cases brought before the Court and maintaining sufficient records to render a full accounting of all moneys received, all disbursements made and the balance of moneys remaining. The Justices are also responsible for establishing internal controls to ensure that all fines and fees received are properly recorded, remitted, and protected against the threat of being lost or stolen. The Justices must ensure that internal controls are working effectively, particularly when there is limited segregation of duties. The Board is responsible for overseeing Court operations and monitoring Court personnel to help ensure that the transactions are properly recorded and reported, and moneys are properly accounted for. This is accomplished, in part, by performing an annual audit of the Justice's records, either by the Board itself, or by engaging the services of an independent public accountant.

Internal controls over the Court's operations were not appropriately designed or operating effectively to allow for proper accounting and reporting of financial activities. Bank reconciliations were not documented for Justice Harrison's account, and monthly bank reconciliations of Justice Portin's account showed a recurring, unresolved surplus balance of \$446 during the audit period. The Justices did not perform a monthly accountability analysis and did not ensure that duplicate receipts were issued for all payments collected by the Court. Further, the Board did not perform an annual audit of the Justices' books and records. As a result, there is an increased risk that Court funds could be misappropriated without detection or correction.

Monthly Bank Reconciliation and Accountability Analysis

A Justice is personally responsible for moneys received by the Court and may be liable for money paid to the Court that was lost or stolen. Therefore, it is essential that each Justice maintain a current, accurate and complete list of all moneys held. Justices are required to account for cash receipts and disbursements from month to month by reconciling the bank accounts.⁷ They also should compare cash on hand and on deposit in the bank to detailed lists of Court liabilities (outstanding bail and amounts due to the JCF and others). This comparison is referred to as an accountability analysis.

The court clerk maintains cash receipts and disbursements records for each Justice and said she makes them available to the Justices every month for review. The court clerk also reviews the bank statement

⁷ Each Justice's account should be zeroed out at the end of the month and, if not, the balance should reconcile to any outstanding checks, and fines and fees received after the end of the month.

activity and prepares bank reconciliations for Justice Portin's account. We reviewed the bank reconciliations completed by the court clerk for Justice Portin's account for the months of June 2011 through August 2012 and found that they reported a recurring, unresolved surplus of \$446.

Bank reconciliations were not documented for Justice Harrison's account for the entire audit period. Rather, the court clerk stated that Justice Harrison normally has little activity, so she only views the statements to identify any unusual transactions.

Neither the Justices nor the clerk performed an accountability analysis. We performed a cash count of undeposited funds with each Justice on October 9, 2012, and prepared an accountability analysis as of that date. We accounted for all funds in Justice Harrison's account and determined that Justice Portin had unidentified funds totaling \$446 in his bank account that were not attributed to activity occurring during the audit period. After completion of field work, the court clerk identified five errors occurring between December 2008 and January 2010 comprising the surplus of \$446 – the identified errors consisted of bail not reported, and four reporting and remitting errors. This variance could have been identified and corrected sooner by preparation of monthly accountabilities.

Cash Receipts

Prompt and accurate recording of receipts is an essential process needed to properly account for and safeguard Court moneys. Justices are required to issue acceptable receipts to acknowledge collection of all moneys paid to the Court. These receipts should be numbered and in at least duplicate form. Receipts should be issued in numerical sequence and a copy should be retained as evidence of collection. Receipts should be recorded in the Justice's accounting system promptly upon issuance to acknowledge collection.

Fines, fees and surcharges are collected by mail and on Court nights. Computer generated receipts are used by the Court; however, sequentially numbered, duplicate receipts were not issued for all collections of fines, fees and surcharges tested. Unless requested, receipts were not issued for payments received by mail or made by check.

We reviewed all 41 cases disposed by both Justices in September 2012, the month preceding our cash count, and the resultant collections totaling \$4,225. Of the 41 cases disposed, the Court collected moneys for 25 cases. We found that 15 of the 25 collections, totaling \$2,010, did not have a receipt issued by the Court. Because the collections were recorded in the cash book report without a receipt number, the collection could not be properly traced. It is possible that 15

collections were for payments that came in by mail; however, we were unable to determine this from available records. Eleven receipts were issued for the remaining 10 collections.⁸

When sequentially numbered duplicate receipts are not consistently issued and properly recorded, the risk is increased that errors or irregularities could occur without detection or correction.

Annual Audit

Village justices are required to present their records and docket at least once a year to be examined by the Board or an independent public accountant (IPA). In conducting its reviews, it is important for the Board to determine whether the Village has effective procedures in place to ensure that the Court's financial transactions are properly recorded and reported, and that all moneys are accounted for properly.

The Board did not perform an annual audit of the Justices' records, nor arrange for an IPA to do so, for the 2011-12 fiscal year. Without an effective audit of the Court's records, including available cash, bail, and monthly accountabilities, Village officials do not have assurance that all moneys received and disbursed by the Court are properly accounted for. Had the Board conducted the required annual audit, the deficiencies identified during our audit may have been identified sooner and prompt corrective action could have been taken.

Recommendations

3. Each Justice should prepare a proper bank reconciliation and accountability analysis on a monthly basis. The Justices should compare all cash on hand and on deposit in the bank to a listing of Court liabilities. Differences should be promptly investigated and corrective action taken as needed.
4. The Justices should ensure that the collection of moneys is promptly receipted with sequentially numbered receipts and entered into the Court's records.
5. The Board should conduct a proper annual audit of the Court's records, as required, and monitor the Court's financial activities on an ongoing basis.

⁸One individual paid with both currency and a money order; receipts were issued for each form of payment.

Accounting Records and Cash Management

The responsibility for effective financial management of the Village rests with the Board. To provide proper oversight, the Board must ensure appropriate policies and procedures are in place and monitor the Treasurer's work to ensure that proper accounting records are maintained. The Board is also required to provide oversight of outsourced services to ensure that the service organization is properly performing those functions. General Municipal Law (GML) authorizes the use of electronic funds transfers and indicates what items are required to be addressed in a local government's written agreement with its banking institution, including security procedures.

During our audit period, the Village was served by a full-time Clerk-Treasurer (June 1, 2011 – December 28, 2011), a part-time Treasurer (December 29, 2011 – September 6, 2012), and an accounting firm hired by the Board to perform the Treasurer's accounting duties (August 29, 2012 – September 26, 2012). Village officials also put a new accounting software system into service after the Clerk-Treasurer retired and the Board appointed a Treasurer.

Internal controls over the Treasurer's activities and the Board's oversight of the Treasurer's financial operations need to be improved. The Treasurer did not properly reconcile all Village bank accounts or update the accounting records in a timely manner. The Board did not ensure the reconciliations prepared by the accounting firm were timely, available to Village officials, and retained on file with Village records. Further, the Board did not ensure that adequate policies, procedures, and agreements were established for online banking and did not provide sufficient oversight of electronic funds transactions. Because of this lack of oversight, the risk is increased that errors or irregularities could occur without being detected and corrected.

Financial Records and Reports

The Village's financial records must be complete, accurate, and up-to date to be useful for managing Village operations. The Treasurer, as CFO, is responsible for performing basic accounting functions, including maintaining accounting records, providing financial reports to the Board, and performing monthly bank reconciliations to ensure the timely identification and resolution of differences between cash balances per the Village's records and the bank statements. Although we found the Village's financial records and reports were generally adequate and complete, we found deficiencies with the preparation of monthly bank reconciliations and the timeliness of postings to the accounting records.

Bank Reconciliations — The reconciliation of bank account balances to general ledger cash balances is an essential control activity. This process provides for timely identification and documentation of differences between the Village's book balances and bank balances. It is important that bank reconciliations be independently reviewed on a regular basis to ensure that they are prepared in a proper manner. An independent review of bank reconciliations provides a unique opportunity for an internal verification of cash receipt and disbursement transactions.

Bank statement activity and bank reconciliations are not independently reviewed, some account reconciliations were not prepared timely, and the Board has not implemented policies and procedures to ensure that bank reconciliations are prepared properly and related documentation is retained on file. Bank reconciliations covering the months of December 2011 through May 2012 that the Treasurer completed showed repeated unresolved variances of as much as \$151 between bank and book balances on four separate accounts. Although the Treasurer left the Village in September 2012, the bank statements for June, July and August 2012 were found unopened in a file (along with unopened notices of returned deposited checks) at the onset of our audit.

The accounting firm allegedly completed bank reconciliations but did not provide them to the Village to be retained with Village records. We requested copies of the bank reconciliations from the accounting firm for the months of August and September 2012 for all accounts, along with any adjusting entries and listings of outstanding checks; the accounting firm did not provide us with this information. Therefore, lacking access to required records, we were unable to review bank reconciliations or confirm the accuracy of the reconciliations for the general, water, and sewer fund bank accounts for August and September 2012. Further, despite repeated requests, the accounting firm did not provide account reconciliations for the trust and agency fund for the months of August and September 2012; initially, firm officials told us that they could not provide this information because reconciliations had not been completed and, then later, because of a software problem.

The Board's failure to ensure that monthly reconciliations were completed timely and accurately by the Treasurer, and that reconciliations prepared by the accounting firm were received, independently reviewed, and retained with Village records, deprives Village officials of important financial information and places taxpayer moneys at unnecessary risk.

Cash Receipts Journal — The Treasurer is required to maintain accurate and complete accounting records. Effective internal control

procedures require that all moneys be recorded in the cash receipts journal when received and the date and amount of deposits be recorded as an aid in reconciling bank accounts. Accounting records should be up-to-date to provide Village officials with accurate interim information.

The Clerk prepares a daily cash sheet to identify the source of moneys collected each day. This cash sheet consists of water and sewer bills, property tax bills, interest and penalties on delinquent tax payments, garbage stickers, and other miscellaneous fees collected.⁹ The Clerk places the daily cash sheet in a folder for the Treasurer to record the receipts in the accounting system.

The Treasurer did not post the receipts from the daily cash sheet to the cash receipts journal in a timely manner, and Village officials were unaware that the cash receipts journals were not up-to-date. We reviewed all 19 cash deposits from the August 2012 collections totaling \$84,423 and found that none of the receipts were posted in a timely manner. Receipts shown on the daily cash sheets, dated from August 7 to August 30, 2012, were not recorded until September 18, 2012. When the accounting records are not updated in a timely manner, the Treasurer's ability to provide the Mayor and Board with accurate financial information is negatively impacted.

Online Banking

GML allows local governments to disburse or transfer funds in their custody by means of electronic transfer. To ensure that Village funds are secure, it is important for the Village to have formal policies and procedures in place that limit the individuals authorized to make electronic transfers, and that require all transfer instructions to be approved prior to execution and independently confirmed after transfer. Additionally, GML requires the Village to enter into an agreement with its financial institutions that provide online banking services that details the authorizations required and the accounts involved.

The Village has not established adequate controls over online banking transactions. The Board has not established a written policy and procedures for online banking transactions. Significant weaknesses exist because disbursements made by electronic funds transfers are not properly authorized or supported by sufficient documentation. There was no written indication of whom made electronic funds transfers or whether electronic funds transfers were ever reviewed. Additionally, a significant segregation of duties weakness exists with the current electronic funds transfer process. The Village also does

⁹ Other miscellaneous receipts may include checks from the Justice Court, code enforcement fees, Planning Board fees, photocopy fees, prior year taxes, final water/sewer bills and sewer hookup fees.

not have a signed online banking agreement with its bank. As a result, these weaknesses create an environment where there is risk that error, fraud, or abuse of Village moneys could occur and not be detected in a timely manner by Village officials.

Electronic Funds Transfers — Cash disbursements made through electronic funds transfers¹⁰ can involve significant amounts of money, be made with relative ease, and leave little tangible evidence (for example, there are no canceled checks) as proof of the transactions. The Board should establish a comprehensive online banking policy that identifies those individuals who will be given online banking access, establish a detailed approval process designed to verify the accuracy and legitimacy of online transfer requests, and require a monthly report of all online banking transactions that occurred during the period. Related control procedures should ensure that an independent person reviews and reconciles this report with the monthly bank statement to verify that all transactions were properly approved and appropriate.

Segregation of duties is critical for electronic funds transfers. The authorization and transmitting functions should not be assigned to the same person. Local governments that outsource financial-related functions must ensure that agreements are in place specifying what services will be provided, when they will be provided, how they will be provided, and at what cost. A written agreement should also stipulate that the service organization will have a process in place to protect the local government's information against loss, abuse, and fraudulent activity.

The Board has not established a written policy and procedures for online banking transactions. The Village routinely makes intra-bank electronic funds transfers, which are internal transfers from one Village bank account to another. Electronic funds transfers are also made for Federal payroll taxes and to the New York State and Local Retirement System for retirement contributions for officials and employees. Prior to September 2012, the Clerk-Treasurer and Treasurer would calculate amounts to be transferred, and the transfer between accounts was executed online by another individual in the Treasurer's office. However, there were no signatures on the transfer instruction sheets evidencing pre-approval prior to execution or an independent review after the transfers were made.

Beginning in September 2012, the Village's accounting firm (a non-Village employee) was allowed access to the Village's online banking

¹⁰ Electronic funds transfers include both internal transfers between Village accounts at the same bank and external transfers (disbursements) to non-Village accounts.

services and performed all of the online banking transactions without any documented oversight. The Village's contract with the accounting firm did not include online banking as a service to be performed and/or address the confidentiality of the Village's information or any technology-based requirements/controls for the accounting firm's computers. This places Village assets at a significant risk of loss or misuse. Further, the accounting firm did not provide the Village with copies of executed transfers or confirmations of transfers made. As a result, there is an increased risk of unauthorized transfers which could allow the potential misuse of funds.

The accounting firm's process also creates an inadequate segregation of duties. The accountant designated for the Village is responsible for initiating and recording electronic funds transfers in the accounting records and preparing bank reconciliations. Village officials were unaware that this poor segregation of duties could potentially result in an improper transfer of Village funds without detection.

We tested 37 electronic funds transfers totaling \$128,859¹¹ and reviewed the corresponding supporting documentation. Twenty-eight were intra-bank transfers totaling \$118,906 and nine totaling \$9,953 were external transfers. Although we did not find any questionable transactions, there was no supporting documentation for nine intra-bank transfers totaling \$58,335, six of which were initiated by the accounting firm. Further, none of the 19 remaining intra-bank transfer requests had evidence of pre-approval or review after execution by the Mayor or Board.

These weaknesses create an environment where there is a risk that fraud, abuse, or misuse of Village moneys could occur and not be detected in a timely manner by Village officials.

Bank Agreement — GML requires an online banking agreement that identifies the manner in which electronic funds transfers will be accomplished, the names and numbers of the bank accounts from which electronic funds transfers may be made, and the individuals who are authorized to request an electronic transfer of funds. According to the New York State Uniform Commercial Code, online banking agreements must also implement a security procedure between the bank and the Village to verify that the payment order is initiated by the Village and to detect errors in the transmission of funds or in the content of the payment order. The security procedure often is implemented through a callback provision that requires the bank to call an individual – other than the person initiating the transaction – to

¹¹ Our sample was taken from bank statement activity of the General, Water, Sewer and Trust & Agency Funds covering the respective months of September 2012, May 2012, June 2012, and August 2012.

confirm the appropriateness of the transfer. To more fully protect the Village's resources, the Village should have a signed online banking agreement with the bank. Such an agreement should place limits on the transactions that can be made (e.g., prohibiting transfers overseas and establishing dollar thresholds).

The Village does not have a signed online banking agreement with the bank. The bank requires the Village to execute an application designating an online banking administrator;¹² however, the administrator of record when we began fieldwork was the former Treasurer. Village officials were not aware of the requirement for a signed agreement as protection for the Village. The Village's failure to have a signed online banking agreement with the bank omits an important level of control that would provide additional security over online banking and electronic funds transfer activities.

Recommendations

6. Village officials should review bank statement activity and bank reconciliations to ensure that reconciliations are prepared timely and accurately, and that any discrepancies are promptly investigated and resolved. Reconciliation documentation should be retained on file.
7. The Board should establish a comprehensive, written online banking policy and require a monthly report of all online banking transactions that have occurred during the period. Procedures should also be established providing for the review and reconciliation of this report with the monthly bank statement by someone independent of the process to verify that all transactions were properly approved and appropriate.
8. Village officials should ensure that the Village's contract with the accounting firm identifies all the services to be performed and provides for a clear understanding of each party's roles and responsibilities. Additionally, Village officials should ensure that the confidentiality of Village information is addressed, including establishing any technology-based requirements.
9. Village officials should ensure there is adequate documentation supporting each electronic funds transfer.
10. Village officials should ensure that there is a signed online banking agreement between the Village and the bank. This agreement should address electronic funds transfers and include security procedures for verifying transfers.

¹² The online banking administrator is required to be a signer on the accounts and has the ability to add, delete, modify, or restrict other individuals' access to the Village's online banking account.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

The local officials' response to this audit can be found on the following page.



August 10, 2013

Division of Local Government and School Accountability
Newburgh Regional Office
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

To Whom It May Concern:

The Village of Chatham greatly appreciates the time and energy that the Division of Local Government and School Accountability has given to us. As we work to improve our practices in administering the Village, the feedback provided has been extremely helpful to the Treasurer and Clerk, as well as elected officials. [REDACTED], was particularly helpful in providing information and resources.

While we will wait to submit a full Corrective Action Plan until the final Report of Examination is issued, we do want you to know that we have begun to implement recommended changes. Village officials recognized that there were inefficient and inaccurate methods of accounting for time and attendance, justice court receipts, and cash management. We fully agree with the findings of the audit and look forward to working together to do the best for the residents of the Village of Chatham.

Sincerely yours,

Thomas Curran
Mayor, Village of Chatham

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard Village assets. The areas selected for audit included payroll, Justice Court operations, cash management, and CFO records and reports. To accomplish our audit objective and obtain relevant audit evidence, our audit included various procedures, as follows.

- We interviewed Village officials to obtain an understanding of internal controls over, and policies and procedures relative to, time, attendance, and leave accruals, Justice Court operations, and the financial operations of the Treasurer. Additionally, we interviewed bank officials to understand security measures used in the online banking system.
- We obtained and reviewed employment contracts and agreements, the Village's Compensation and Benefits Manual, and the Employment Practices Compliance Manual.
- We selected a judgmental sample of 20 employees, consisting of all full-time employees and 10 part-time employees, to test the accuracy of hours and pay rates paid, and to determine if timesheets contained employee and supervisory signatures.
- We obtained all timesheets and payroll summaries submitted by all full-time employees and compared them to attendance cards to verify the amount and type of leave time earned and used, and the calculation of accrual balances.
- We examined accounting and bank records and performed a cash count of moneys collected and on hand for the Justice Court.
- We reviewed the Court's completed bank reconciliations and prepared accountability analyses.
- We examined disposed Court case files and compared the information reported to the JCF to assess the accuracy and completeness of the records.
- We assessed the segregation of duties related to online banking functions.
- We obtained and reviewed bank agreements and contracts with outsourced service providers.
- We reviewed available CFO bank reconciliations for accuracy.
- We traced online banking transfer activity from bank statements to source documents to verify accuracy and compliance.
- We traced cash disbursements journal postings to abstracts, original invoices, and vouchers to test for accuracy of the journal, and traced general journal entries to original source documents for accuracy.
- We assessed the timeliness of deposits and postings to accounting records.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

HOW TO OBTAIN ADDITIONAL COPIES OF THE REPORT

To obtain copies of this report, write or visit our web page:

Office of the State Comptroller
Public Information Office
110 State Street, 15th Floor
Albany, New York 12236
(518) 474-4015
<http://www.osc.state.ny.us/localgov/>

APPENDIX D
OFFICE OF THE STATE COMPTROLLER
DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

Andrew A. SanFilippo, Executive Deputy Comptroller
Nathalie N. Carey, Assistant Comptroller

LOCAL REGIONAL OFFICE LISTING

BINGHAMTON REGIONAL OFFICE

H. Todd Eames, Chief Examiner
Office of the State Comptroller
State Office Building - Suite 1702
44 Hawley Street
Binghamton, New York 13901-4417
(607) 721-8306 Fax (607) 721-8313
Email: Muni-Binghamton@osc.state.ny.us

Serving: Broome, Chenango, Cortland, Delaware,
Otsego, Schoharie, Sullivan, Tioga, Tompkins Counties

BUFFALO REGIONAL OFFICE

Robert Meller, Chief Examiner
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo, New York 14203-2510
(716) 847-3647 Fax (716) 847-3643
Email: Muni-Buffalo@osc.state.ny.us

Serving: Allegany, Cattaraugus, Chautauqua, Erie,
Genesee, Niagara, Orleans, Wyoming Counties

GLENS FALLS REGIONAL OFFICE

Jeffrey P. Leonard, Chief Examiner
Office of the State Comptroller
One Broad Street Plaza
Glens Falls, New York 12801-4396
(518) 793-0057 Fax (518) 793-5797
Email: Muni-GlensFalls@osc.state.ny.us

Serving: Albany, Clinton, Essex, Franklin,
Fulton, Hamilton, Montgomery, Rensselaer,
Saratoga, Schenectady, Warren, Washington Counties

HAUPPAUGE REGIONAL OFFICE

Ira McCracken, Chief Examiner
Office of the State Comptroller
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, New York 11788-5533
(631) 952-6534 Fax (631) 952-6530
Email: Muni-Hauppauge@osc.state.ny.us

Serving: Nassau and Suffolk Counties

NEWBURGH REGIONAL OFFICE

Tenneh Blamah, Chief Examiner
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, New York 12553-4725
(845) 567-0858 Fax (845) 567-0080
Email: Muni-Newburgh@osc.state.ny.us

Serving: Columbia, Dutchess, Greene, Orange,
Putnam, Rockland, Ulster, Westchester Counties

ROCHESTER REGIONAL OFFICE

Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614-1608
(585) 454-2460 Fax (585) 454-3545
Email: Muni-Rochester@osc.state.ny.us

Serving: Cayuga, Chemung, Livingston, Monroe,
Ontario, Schuyler, Seneca, Steuben, Wayne, Yates Counties

SYRACUSE REGIONAL OFFICE

Rebecca Wilcox, Chief Examiner
Office of the State Comptroller
State Office Building, Room 409
333 E. Washington Street
Syracuse, New York 13202-1428
(315) 428-4192 Fax (315) 426-2119
Email: Muni-Syracuse@osc.state.ny.us

Serving: Herkimer, Jefferson, Lewis, Madison,
Oneida, Onondaga, Oswego, St. Lawrence Counties

STATEWIDE AUDITS

Ann C. Singer, Chief Examiner
State Office Building - Suite 1702
44 Hawley Street
Binghamton, New York 13901-4417
(607) 721-8306 Fax (607) 721-8313